

Property Tax Advisory

Property Tax Advisories are interpretive statements authorized by RCW 34.05.230.

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Low-Income Housing Valuation

Background

This Property Tax Advisory (PTA) provides assistance to both assessors and taxpayers in determining the true and fair market value of low-income restricted housing. Valuation of these properties has been a national issue for at least the past two decades, and courts and administrative boards throughout the country have struggled with how best to resolve the very complex issues associated with it.

The number of low-income, rent-restricted properties has increased steadily, but the valuation of such properties in the various counties has lacked consistency. This in turn has led to many appeals of the assessed values of these properties, with great cost in time and money for both the taxpayers and the assessors associated with those appeals. It is hoped that using this PTA in conjunction with the accompanying Low Income Housing Valuation Guide will help reduce the necessity for appeals of assessed value and ensure that these properties will be valued at the statutorily required value, that is, 100 percent of true and fair value.

This PTA, together with the Low-Income Housing Valuation Guide that accompanies it, incorporates generally accepted appraisal practices with Washington statutory and appellate court case law. Appraisal theory and practice and Washington case law have long held that the basis for determining the value of real property is all the factors that enter into a sale of property between a knowledgeable willing seller and a knowledgeable willing buyer who are not compelled to sell or buy. Furthermore, Washington case law is clear that “where private land is leased, the entire estate including the fee, the leasehold and any improvements thereon, is assessed and taxed as a unit . . .” *Duwamish Warehouse Co. v. Hoppe*, 102 W. 2d 249, 253; 684 P. 2d 703 (1984). (See also, *Folsom v. County of Spokane*, 106 W. 2d 760, 725 P. 2d 987 (1986) [“*Folsom I*”] and *Folsom v. County of Spokane*, 111 W. 2d 256, 759 P. 2d 1196 (1988) [“*Folsom II*”].) (See also, *Twin Lakes Golf Club v. King County*, 87 W. 2d 1, 548 P. 2d 538 (1976).)

In the context of valuing restricted rent and restricted use housing, there is currently only one Washington appellate court decision, *Cascade Court Limited Partnership v. Noble*, 105 Wash. App. 563, 20 P.3d 997 (2001). That decision affirms the importance of the willing buyer and willing seller concept, and it goes on to conclude that the restricted rents of property in a low-income housing

program, as opposed to the market rents of conventional housing, are to be taken into account by the assessor when valuing the rent-restricted property.

Valuation Overview

Assessors will encounter four broad classes of low-income multifamily housing that are distinguished by their capital financing structure: (1) low-income housing tax credit (LIHTC) projects; (2) subsidized mortgage projects (for example, U.S. Department of Agriculture Rural Development [USDA-RD] Section 515 or U.S. Department of Housing and Urban Development [HUD] Section 236); (3) those which proportionately encompass both LIHTC and USDA-RD/HUD projects; and (4) restricted-use projects that also have market-rate rental units. The assessor should have a basic understanding of the characteristics of the various low-income multifamily housing programs and consult with the proper regulatory agency to determine property-specific restrictions. This PTA summarizes the Department of Revenue's valuation advice. For a more thorough issue discussion, refer to the Low-Income Housing Valuation Guide.

Taxpayers share responsibility with the assessor for a fair and equitable value conclusion. It is unfair to expect an assessor to consider the important facts that "willing sellers" and "willing buyers" consider without providing those facts. For that reason, taxpayers must provide "pertinent data ... and other facts necessary for appraisal of the property" (WAC 458-07-030(5)) on a timely basis.

Income capitalization is the preferred approach for valuing low-income multifamily housing. Direct capitalization supported with comparable income-producing property transactions that would appeal to the same category of prospective purchaser provide the most compelling value indication. Either direct capitalization or yield capitalization may correctly produce a supportable value indication when based on relevant market information derived from comparable properties. Yield capitalization is not generally recommended unless the assessor can substantiate the inherent assumptions, nor is it discussed in this PTA or the Low-Income Housing Valuation Guide.

The sales comparison approach is applicable when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market. To ensure the reliability of the value conclusions derived by applying the sales comparison approach, the assessor must verify the market data obtained and fully understand the behavior characteristics of the buyers and sellers involved in property transactions of these types.

The cost approach is not recommended.

The appraisal approach hierarchy recommended in this PTA is in harmony with the statute, RCW 84.40.030(2). The assessor is not restricted to only one approach and may use any combination of the three appraisal approaches. The valuation approach or approaches used depend on the quality and quantity of the data available as well as whether the approach(s) used are the most applicable available given the unique circumstances of the property being assessed. Because there will usually not be sufficient sales to determine value, the income approach is usually preferred for these properties. When there are valid comparable sales, the sales approach may be used. If there is a lack of either income data or valid comparable sales, the cost approach may be used.

Income Approach

Estimating Rents, Expenses, and Net Operating Income

The goal when reconstructing an operating income statement is to estimate the rents, expenses, and net operating income an owner will anticipate from operating the property prudently.

The assessor should use the lower rent, chosen from either restricted rent or market rent. The rent that should be used in the valuation of the LIHTC property is the achievable restricted rent that is supported by the restricted market, meets the tax credit program requirements, and satisfies the project-based agreements. The assessor should estimate the achievable restricted rents. Achievable restricted rent is never more than maximum gross rent or maximum allowable rent.

Section 515 rents are negotiated between the owner and USDA-RD yearly, based on the projected operating budget. Therefore, because the potential gross income for Section 515 properties is project specific, the assessor must request the required income information from the taxpayer.

Vacancy rates tend to be lower for both LIHTC and Section 515 projects than for market-rate properties in the same markets. Market studies should determine the correct vacancy and collection loss rate. Operating expenses are mainly market determined. The assessor should review expenses on a line-by-line basis and make an overall expense-per-unit-per-year comparison. Some expense items that tend to be more for restricted-use properties than for conventional apartments are audits, tenant income verification, additional regulatory reports, and required replacement reserves.

When selecting comparable sales for direct capitalization, the assessor should consider the factors discussed in the Sales Comparison section on page 4 of this PTA. If similar restricted-use capitalization rates are unavailable, the assessor should estimate the appropriate rate from conventional multifamily sales. The overall capitalization rates of low-income projects are neither automatically higher nor lower than unrestricted projects. Quantitative rate adjustments can be estimated using generally accepted appraisal principles. The general formula linking direct and yield capitalization is $Y_o = R_o + CR$, where Y_o is the yield rate, R_o is the capitalization rate, and CR is the change rate (growth in income and value). The selected rate is dependant on the same forces as unrestricted projects: market area characteristics, rent advantages or disadvantages, income quality and durability, expense control risks, and program structure.

Direct Capitalization Basic Steps

This methodology is applicable to any property with long-term, below-market rents, at any point in its restricted-use period. The Department recommends this method when there are not enough similar, restricted-use, comparable sales to derive a reliable value indication. This method plainly identifies “as if” unrestricted, leased fee, leasehold, leasehold reversion, and “as” restricted values. The assessor must be familiar with basic income direct capitalization methodology, the present value of money theory, reconstructing operating income statements, and terminology.

An assessor using this method effectively demonstrates compliance with RCW 84.40.030(1). The method shows that other highest and best uses, such as conventional apartments, were considered and **not used** as the valuation basis. It also demonstrates compliance with RCW 84.40.030(2):

“Consideration should be given to any agreement, between an owner of rental housing and any

government agency, that restricts rental income, appreciation, and liquidity; and to the impact of government restrictions on operating expenses and on ownership rights in general of such housing.”

1. Determine the unrestricted market value.
2. Determine the owner’s restricted leased fee value.
3. Compute the owner’s positive leasehold reversion value.
4. Compute the present value of the owner’s positive leasehold reversion.
5. Compute the restricted use value. Add the present value of the owner’s positive leasehold reversion (determined in Step 4) to the owner’s restricted leased fee value (determined in Step 2).

The value concluded is the leased fee value plus any value created by sellers and buyers anticipating rents, expenses, and net operating income changing to market-based levels when use restrictions end. This method results in three values for the assessor to reconcile: unrestricted market value, restricted leased fee value, and restricted use value. When an assessor follows this methodology step by step, the value conclusion will be fully developed.

Sales Comparison

The sales comparison approach is applicable when there are sufficient recent, reliable transactions to indicate value patterns or trends in the market. Generally, a LIHTC project is not similar to conventional or Section 515 projects, and restricted-use properties should not be compared across program lines. In addition to the typical elements of comparison, the assessor should consider geographic area, area median income, expense ratios, tenant mix, and the income change rate. The assessor must consider the program use restrictions, reversion date, and factors willing sellers and willing buyers would consider.
